# INDEX


| | Page |
|---|---|
| Opinions below | 1 |
| Jurisdiction | 1 |
| Questions presented | 2 |
| Statute involved | 2 |
| Statement | 4 |
| Argument | 8 |
| Conclusion | 11 |


## CITATIONS

Cases:


| | |
|---|---|
| *Allen* v. *Beazley*, 157 F. 2d 970 | 10 |
| *Commissioner* v. *Court Holding Co.*, 324 U. S. 331 | 10 |
| *Commissioner* v. *Hart*, 76 F. 2d 864 | 10 |
| *Commissioner* v. *Tower*, 327 U. S. 280 | 8, 9, 10 |
| *Durwood* v. *Commissioner*, 159 F. 2d 400 | 10 |
| *Lusthaus* v. *Commissioner*, 327 U. S. 293 | 8, 9 |


Statutes:

Internal Revenue Code:


| | |
|---|---|
| Sec. 22 (26 U.S.C. 22) | 2 |
| Sec. 24 (26 U.S.C. 24) | 3, 8 |

# In the Supreme Court of the United States

OCTOBER TERM, 1948

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No. 105

O. PHIL NORDLING AND GILL NORDLING, PETITIONERS

*v.*

COMMISSIONER OF INTERNAL REVENUE

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*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT*

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## BRIEF FOR THE RESPONDENT IN OPPOSITION

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### OPINIONS BELOW

The memorandum opinion of the Tax Court (R. 166-185) is not reported. The opinion of the Circuit Court of Appeals (R. 210-213) is reported at 166 F. 2d 703.

### JURISDICTION

The judgment of the Circuit Court of Appeals was entered on March 23, 1948. (R. 214.) The petition for a writ of certiorari was filed on June

18, 1948. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

## QUESTIONS PRESENTED

1. Whether a partnership having federal income tax significance existed between Gill Nordling and his wife, Bernice.

2. Whether Gill Nordling should be taxed on the dividends from corporate stock held in the name of his wife.

3. Whether O. Phil Nordling should be allowed a capital loss on the sale of corporate stock—the answer being dependent upon whether the transactior was between members of a family within the meaning of Section 24(b)(1)(A) of the Internal Revenue Code.

## STATUTE INVOLVED

Internal Revenue Code:

SEC. 22. GROSS INCOME.

(a) [as amended by Sec. 1, Public Salary Tax Act of 1939, c. 59, 53 Stat. 574] *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from

professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(26 U.S.C. 22.)

SEC. 24. ITEMS NOT DEDUCTIBLE.

* * *

(b) Losses from Sales or Exchanges of Property.—

(1) *Losses disallowed.*—In computing net income no deduction shall in any case be allowed in respect of losses from sales or exchanges of property, directly or indirectly—

(A) Between members of a family, as defined in paragraph (2)(D);

* * *

(2) *Stock ownership, family, and partnership rule.*—For the purposes of determining, in applying paragraph (1), the ownership of stock—

* * *

(D) The family of an individual shall include only his brothers and sisters (whether by the whole or half blood),

spouse, ancestors, and lineal descendants; and

* * *

(26 U.S.C. 24.)

STATEMENT

The facts, as found by the Tax Court (R. 167-179) and as recited in the opinion of the court below (R. 210-212), may be summarized here as follows:

The petitioners, O. Phil and Gill Nordling, are brothers who during 1941 were operating, as a partnership under the name "Nordling Parts Company", two automobile parts stores in Oregon. They also owned substantially all of the stock of the Nordling Finance Company, a corporation which owned and rented to the partnership the physical equipment used in the partnership business. (R. 167-168.)

In August, 1941, after a preliminary exchange of letters, Phil Nordling offered (by letter dated August 19, 1941) to sell to Gill Nordling for $18,500 his partnership and corporate interests, or to buy the interest of Gill Nordling for the same price.[1] On August 28, 1941, Gill Nordling accepted

[1] This offer was made pursuant to a "buy or sell" provision contained in their partnership agreement (Resp. Ex. F, one of the exhibits which were not included in the printed record on review, but were transmitted in their original form, pursuant to order of the court below (R. 196-197)), to the effect that either partner might make an offer to buy from or sell to the other partner, and in the event of failure of the other to elect to buy or sell within thirty days the partnership was to be

Phil Nordling's offer to sell, and sent with his letter of acceptance his check for $50 to show his "good will". (R. 168-169.)

Gill Nordling turned all of these letters over to an attorney, advising him that he (Gill Nordling) and his wife, Bernice, were going to take over the business as partners, and the attorney, pursuant to Gill Nordling's instructions, prepared a formal sales contract which included the wife's name as a purchaser. Phil Nordling was unaware of any arrangement between Gill Nordling and his wife until the final papers were presented to him for execution. The suggestion that the wife be taken in as a partner originated from a conference with a tax consultant whom Gill Nordling had consulted regarding the purchase of Phil Nordling's interests. (R. 169.)

After the $50 paid with the letter of acceptance, the balance of the sales price of $18,500 was discharged by a cash payment upon the execution of the contract in the amount of $2,950, which was borrowed from a bank, and by a note in the amount of $15,500. Both notes were signed by Gill Nordling and his wife, Bernice, and both were ultimately paid out of the profits of the Nordling Parts Company. (R. 169-171.)

On September 10, 1941, six days prior to the execution of the formal contract, a partnership

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dissolved—no provision being made for selling a partnership interest to any third party.

agreement had been entered into between Gill Nordling and his wife. (R. 172-177.)[2]

At the time of the transaction here involved Bernice Nordling owned no separate property. She and her husband had four children ranging from eight to fourteen years in age. She worked for the partnership about one week in 1941, and about two weeks in each of 1942 and 1943. (R. 177.)

Under the partnership agreement, Gill Nordling was to receive a salary of $200 per month (R. 173), for his personal services. His wife withdraw $150 a month until the end of 1943, and $300 a month thereafter. While there was no evidence as to how she spent that money, Gill Nordling testified that in the later period they withdrew $600 a month for living expenses, which was approximately the total amount of the withdrawals of both. (R. 178.)

Bernice Nordling contributed to the business no services of a vital or controlling nature and no capital originating with her. She was only a nominal party to the transaction, in which her husband and his brother were the real parties in interest, and it was not the intention of any of the

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[2] The agreement, amongst other things, provided that Gill Nordling diligently employ himself in the business, and that he be its general manager—but made no provision for the performance of any services by his wife. The agreement recited contributions of capital to the partnership of some $18,000 by Gill Nordling and some $6,000 by his wife. (R. 173.) Later, in 1943, Gill Nordling, to equalize their shares as shown on the books, transferred to his wife an interest of some $4,800 on the books, and he filed a gift tax return reporting the gift. (R. 178.)

parties that she acquire the real ownership of either the partnership interest or the corporate stock for the purchase of which her husband alone had negotiated. (R. 178-179.)

Pursuant to the agreement between Phil and Gill Nordling, the stock held by them (as well as a small amount held by a third brother) in the Nordling Finance Company was surrendered, and new certificates were issued in the name of Gill Nordling and his wife. Phil Nordling sustained a long-term capital loss of $3,759.45 on the disposition of his stock. (R. 171-172.)

Upon the basis of the facts in the case, the Tax Court concluded that no partnership existed between Gill Nordling and his wife which could be recognized for federal income tax purposes, and that the real purchaser of Phil Nordling's stock was his brother, Gill Nordling. (R. 179.) Accordingly, the Tax Court sustained the Commissioner on all three questions in the case, holding in effect that all the income from the parts business and the dividends on the stock held in the name of the wife were taxable to petitioner Gill Nordling, and that petitioner Phil Nordling was not entitled to deduct any loss on the purported sale of stock to his sister-in-law since the real purchaser thereof was his brother Gill Nordling.[3] (R. 179-185.)

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[3] Petitioner Phil Nordling had conceded before the Tax Court that he was not entitled to deduct any loss with respect to that part of his stock sold to his brother, because of the provisions of Section 24(b)(1)(A) of the Code. (R. 184.)

The court below affirmed the decision of the Tax Court. (R. 210-213.)

ARGUMENT

1. The fundamental issue, upon which all three questions in the case necessarily turned (R. 179-180, 184, 212-213), was as to the reality of the transaction in which by a "last minute substitution", as the Tax Court characterized it (R. 179), the wife participated in the purchase of the partnership and corporate interests in the business which Gill Nordling had contracted to buy from his brother Phil Nordling. Upon the facts, the Tax Court, viewing her participation as "artificial in the extreme rather than real" (R. 181), concluded that the wife did not become the owner either of the partnership interest or of the corporate stock "in such a real sense" (R. 181) as to be recognized as owner for federal tax purposes (R. 180-184).

In reaching this conclusion, the Tax Court properly observed the principles enunciated by this Court in *Commissioner* v. *Tower,* 327 U. S. 280, and *Lusthaus* v. *Commissioner,* 327 U. S. 293. The court below correctly affirmed, upon the authority of those cases. (R. 212-213.) Clearly, there is no occasion for any further review of this question.

In view of the conclusion that the participation of the wife was purely nominal, the disallowance (R. 185, 213) upon the basis of Section 24(b)(1)(A) of the Internal Revenue Code, *supra,* of a deduction to Phil Nordling for a loss on the pur-

ported sale of stock to her was likewise correct, and no review is warranted upon that phase of the case.

2. Virtually the same contentions as made during the course of petitioners' extensive argument (Br. 26-60) have been considered and rejected by this Court in the *Tower* and *Lusthaus* cases and by various circuit courts of appeals in numerous subsequent cases. Certiorari was sought in many of those cases, but this Court has declined review in each instance.

Much of petitioners' argument (Br. 26-37) is really addressed to the claimed significance of portions of the evidence, the weight to be accorded thereto, the inferences to be drawn therefrom, and the like—matters clearly within the province of the Tax Court, which made findings of fact which the court below correctly held were supported by the evidence. (R. 212.)

3. Clearly, the decision below is not inconsistent with the *Tower* and *Lusthaus* cases, as urged by the petitioners (Pet. 16), who, in support of their position, point out that in those cases the husband undertook to vest in the wife a fractional interest in a business which he had theretofore owned and operated, while here, it is argued, the wife acquired an interest in the business from a third person (Br. 37-40). But the Tax Court found that the purported transaction lacked reality, and that the wife was only a nominal participant in the purchase. (R. 183.) For this same reason, there is no conflict,

as claimed (Pet. 16), with *Durwood* v. *Commissioner,* 159 F. 2d 400 (C. C. A. 8th), where the wife and children of the taxpayer were treated as having actually acquired interests in the pre-existing partnership from persons other than the taxpayer.

4. Nor is there any conflict, as urged (Pet. 17-18), with *Allen* v. *Beazley,* 157 F. 2d 970 (C.C.A. 5th), or *Commissioner* v. *Hart,* 76 F. 2d 864 (C. C. A. 6th). In the *Beazley* case, where no family partnership and no question of operation of the business were involved (157 F. 2d 974), it was held that the three members of the family were taxable upon their respective shares of the income from securities found as a fact to have been actually and bona fide purchased and owned by them; the court, concluding that the transaction had reality, stated that it is the "actuality" (*id.* p. 973) accompanying a family arrangement which determines its effect for tax purposes. Here, the arrangement having been found to lack reality, the "papers" which had been drawn up (cf. *Commissioner* v. *Tower, supra,* p. 291) were correctly held ineffective for tax purposes. Cf. *Commissioner* v. *Court Holding Co.,* 324 U. S. 331. The *Hart* case clearly has no bearing on the instant case: It holds, in view of Michigan law, taxable one-half each to the husband and wife the income received by them as vendors under a contract for the sale of Michigan land owned by them as tenants by the entirety.

CONCLUSION

The decision below is correct. It turns upon the particular facts of the case and presents no question calling for further review by this Court. There is no conflict of decisions. The petition should therefore be denied.

Respectfully submitted,

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JULY, 1948.

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